



TAX LAW FOR BUSINESS  
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## **Taxation of non-stock, non-profit hospitals**

TAXATION of non-stock, non-profit organizations had always been a controversy. There are a number of types or classes of organizations or associations exempted from income taxes by the Tax Code. So these types of organizations are the usual channel through which activities are pursued if the intention is not for profit.

But despite the clear exemption from income taxes, the number of cases pursued administratively and litigated in the courts would indicate that the taxation of these class of organizations is not that clear after all.

Among the types of organizations exempted from income taxes are non-stock corporations organized for charitable purposes and not for profit, but operated exclusively for the promotion of the general welfare. For one to invoke exemption from income tax, it must be organized as non-stock and operated for the purposes in which it was organized. That classification itself had been an issue in the area of income taxation. The Court had repeatedly defined what a non-stock organization is but its relevance keeps popping every time a tax-related issue is involved.

So what really constitutes a non-stock corporation? Once again, the Supreme Court, in GR 195909 and 195960, September 26, 2012, referred to the definition in the Corporation Code of a "non-stock corporation" as "one where no part of its income is distributable as dividends to its members, trustees, or officers and that any profit obtained as an incident to its operations shall whenever necessary or proper, be used for the furtherance of the purpose or purposes for which the corporation was organized."

That case involves the income taxation of a non-stock and non-profit hospital organized for charitable and for social welfare purposes. The institution claims that it is exempt from income taxation under Section 30 of the Tax Code, which exempts this kind of institution from income taxation. The tax authority, on the other hand, claims that it should be subject to income tax under Section 27(B) of the Tax Code, which imposes 10-percent income tax on proprietary and nonprofit hospitals.

As decided by the Court, a non-stock, non-profit corporation is indeed exempt from income taxation. That exemption, however, is intended solely for the activities of a non-stock, non-profit entity which are “operated exclusively” for charitable or social welfare purposes. Any other income that may be generated by these entities shall be subject to the 10-percent preferential tax rate the tax imposed on proprietary non-profit hospitals.

Apparently, according to the Court, “proprietary” means “private,” and when applied to a hospital means private hospital. On the other hand, “non-profit” means no net income or asset accrues to or benefits any member or person, with all net income or asset devoted to the institution’s purposes and all its activities conducted not for profit.

Thus, if a hospital not organized for profit, generates income not in relation to its charitable or social welfare purposes, it shall be taxed at the preferential rate of 10 percent. Simply put, even if a hospital does not distribute income to its members or trustees and uses the income proceeds from non-related activities in furtherance of its purposes, the same shall still be taxable at a rate of 10 percent.

The implication of this is that a non-stock, non-profit organization, including a hospital, organized for charitable and/or for purposes of promoting the general welfare is not subject to income tax. The exemption, however, extends only to the activities pursued exclusively for such purposes, that is, not-for-profit activities. That exemption is not lost even if said entity involves itself in activities conducted for profit. But these revenues derived from profit-generating activities will be subject to income tax. With respect to hospitals, that income tax shall not be the regular income tax rate of 30 percent but the special income tax rate of 10 percent imposed on proprietary and nonprofit hospitals.

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